Supreme Court, U.S.
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No. 87-984

In The
Supreme Court of the United States
October Term, 1987

SHELL OIL COMPANY,
Appellant,
v.
THE IOWA DEPARTMENT OF REVENUE,
Appellee.

On Appeal from the Supreme Court of Iowa

MOTION OF APPELLEE TO DISMISS OR AFFIRM

THOMAS J. MILLER
Attorney General of Iowa
Hoover State Office Building
Des Moines, Iowa 50319
(515) 281-5164
Of Counsel

HARRY M. GRIGER
Special Assistant Attorney General
Hoover State Office Building
Des Moines, Iowa 50319
(515) 281-5846
Counsel of Record for Appellee

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

QUESTION PRESENTED

Whether the State of Iowa is prohibited by the Outer Continental Shelf Lands Act, 43 U.S.C. § 1333(a), from imposing a tax upon its apportioned share of a unitary net income base, in the absence of evidence that the apportioned share exceeds net income derived from the taxpayer's income producing activities in Iowa.

PARTIES TO PROCEEDINGS BELOW

The parties before the Supreme Court of Iowa with respect to the question presented were Shell Oil Company and the Iowa Department of Revenue.

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MOTION TO DISMISS OR AFFIRM

In accordance with Sup. Ct. R. 16, the Appellee, Iowa Department of Revenue, moves to dismiss the appeal of Shell Oil Company (Shell) on the grounds that the appeal does not present a substantial federal question or to affirm the decision of the Supreme Court of Iowa for the reason that 43 U.S.C. § 1333(a) does not implicate a state unitary business/formula apportionment method not shown to result in an income attribution to the taxing state in excess of net income derived from the taxpayer's income producing activities in that state.

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STATEMENT OF THE CASE

In the years 1975 through 1980, Shell's principal business activities were the exploration for, and development, production, transportation, purchase, and marketing of crude oil and natural gas, and the purchase, manufacture, and marketing of oil and chemical products. (J.S. App. 16a; Stip. par. 2).[1] Shell has stipulated that its operations, within and without the outercontinental shelf (OCS), including its Iowa activities, constitute a single unitary business similar to those in *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980). (J.S. App. 18a; Stip. par. 7).

Shell's Exploration and Production Organization Division transferred most, but not all, of Shell's OCS crude

[1]References to the "Appendices" attached to Shell's Jurisdictional Statement will be to "J.S. App." References to Shell's Jurisdictional Statement text will be "J.S."

oil to the continental United States. (J.S. App. 17a, 20a; Stip. pars. 4, 21). This crude oil was either exchanged with other oil companies or was first refined by Shell and then sold or exchanged. (J.S. App. 20a; Stip. par. 21). If the crude oil was refined by Shell, it was commingled with crude oil from other sources so that the ultimate source of the oil (OCS or non-OCS) is indeterminable. (J.S. App. 17a-18a; Stip. par. 6).

The intracompany transfers of Shell's extracted crude oil were to Shell's Products Organization Division. (J.S. App. 17a; Stip. par. 4). These transfers were recorded by Shell as "sales", but no money was ever paid. (J.S. App. 17a; Stip. par. 4). These recorded transfers occurred with respect to crude oil production in OCS and in non-OCS areas. (J.S. App. 17a; Stip. par. 4). Shell was a "net purchaser" of crude oil, that is, Shell's total crude oil production was insufficient to satisfy Shell's crude oil requirements, so that Shell purchased the balance of its crude oil needs from other sources, including OCS producers, domestic producers, and foreign source producers. (J.S. App. 17a; Stip. par. 4).

Shell also produced natural gas in the OCS. In contrast to crude oil, Shell sold all of its OCS natural gas at the OCS wellhead to natural gas transmission companies for cash. (J.S. App. 7a-8a).

Shell's unitary Iowa business activities involved the sale of oil and chemical products which Shell had refined and manufactured outside of Iowa. (J.S. App. 17a; Stip. par. 6). Shell sold crude oil based products in Iowa which it had manufactured from commingled OCS and non-OCS oil. (J.S. App. 17a-18a; Stip. par. 6).

Iowa imposes an income tax upon corporations doing business in Iowa. The unitary net income of a corporation is determined with respect to taxabale income computed for federal income tax purposes.[2] (J.S. App. 96a). The unitary net income of a corporation, such as Shell, which does business within and without Iowa is apportioned by application of a single sales factor formula in order to obtain a reasonable estimate of Iowa net income. This method of apportionment was upheld, against constitutional attack upon Due Process and Commerce Clause grounds, in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978).[3] Shell concedes that the Iowa sales formula apportionment method properly attributes its income to Iowa and that Shell could not challenge the Iowa formula on Due Process or Commerce Clause grounds. (J.S. 7, 12).

The Iowa Department of Revenue audited Shell's Iowa income tax returns and assessed additional Iowa tax to Shell.[4] Shell protested the assessment and claimed that it

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[2]Iowa Code § 422.35 does contain some adjustments to the federal taxable income figure, but these adjustments are not relevant to this case.

[3]The Iowa Supreme Court has interpreted the Iowa unitary business/formula apportionment method for determining Iowa taxable income as one which "manifests an intent on the part of the legislature to impose a tax on all foreign corporate activities in Iowa that can reasonably be said to produce income." *American Home Products Corporation v. Iowa State Board of Tax Review*, 302 N.W.2d 140, 144 (Iowa 1981); *Internorth, Inc. v. Iowa State Board of Tax Review*, 333 N.W.2d 471, 475 (Iowa 1983).

[4]For the years 1975-1980, Shell's Iowa income tax returns disclosed that Shell computed its Iowa taxable income under

(Continued on following page)

resulted in the taxation of Shell's income derived from the OCS and was in violation of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. §§ 1331 *et seq.* (J.S. App. 65a-66a; Stip. par. 43). An administrative hearing was held on Shell's protest. Shell's calculation of its alleged OCS earned income from the extraction of oil and gas on the OCS was never conceded by Iowa and, in fact, was disputed. (MDA. App. Exhibit N; pars. 3-10). Shell's evidence consisted of its calculation of its alleged OCS net income figure by its separate accounting method and its assertion that, absent such calculation and deduction of that income figure from the unitary net income base, Iowa taxed Shell's OCS income in its assessment. Shell did not present any evidence with respect to its Iowa profits or profits from any other non-OCS portion of its unitary business. The administrative decision contained a finding that Shell failed to prove that the assessment taxed its OCS income. (J.S. App. 71a-72a; par. 11). The administrative decision found that the assessment did not violate the OCSLA.

Shell petitioned the Polk County District Court for judicial review of the administrative decision. That Court

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(Continued from previous page)

three different methods. (MDA. App. Exhibit N, par. 7). Two of the three methods did not involve any modification of the unitary net income base. For 1977, 1978, and 1979, Shell calculated its Iowa taxable income by the method described in page 27a of the appendix to the Jurisdictional Statement that depicts its modification to the Iowa unitary business/formula apportionment method. The Department of Revenue audit uniformly included all of Shell's operating unitary net income in the apportionable income base and attributed a portion of that income to Iowa by the Iowa sales formula, the numerator of which contains Shell's Iowa sales and the denominator of which contains Shell's sales in the rest of the world.

held that the OCSLA prohibited state extraterritorial taxation of the OCS, but did not prohibit a tax related to activities in the taxing state. (J.S. App. 33a). The Court found that Shell was not subjected to extraterritorial taxation.

The Iowa Supreme Court affirmed the decision of the District Court on Shell's appeal with respect to the OCS issue.[5] The Court rejected Shell's claim that the OCSLA inherently required an exclusion of a computed OCS net income figure from the unitary net income base. (J.S. App. 9a). The Court held that in an analysis of the OCS issue, the focus should be on the "tax consequences" produced by the apportionment, and not the components included within the unitary business/formula apportionment. (J.S. App. 13a). The Court did not view the exclusion by Florida of Shell's actual OCS revenues in the apportionment to justify a different result in the instant case in which actual revenues from the sales by Shell of natural gas at OCS wellheads were included in the apportionment.[6] (J.S. App. 10a). The Court concluded (J.A. App. 13a):

> The inclusion of OCS revenues in gross sales for purposes of applying the statutory apportionment

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[5]Shell prevailed on its contention that the assessment with respect to years 1975, 1976, and 1977 was untimely under provisions of Iowa law. The decision on this contention is unrelated to the issue before this Court.

[6]The Court agreed with the Florida Supreme Court's decision in *Shell Oil Co. v. Department of Revenue*, 496 So.2d 789 (Fla. 1986), in which that Court rejected Shell's interpretation of the OCSLA and held that a state unitary net income base which included sales outside of the OCS of minerals extracted in the OCS did not implicate the OCSLA.

> formula contained in Iowa Code section 422.33 (2)(b)(4) apparently aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities. That, of course, is the goal of any apportionment formula. We cannot attribute to Congress an intent to impede this legitimate goal in the absence of some compelling indication that such was its intention in passing the OCSLA. We fail to divine any such intention from either the legislative history or language of the Act. We conclude that the district court properly rejected Shell's petition for judicial review on this issue.

In its appeal to this Court, Shell has limited its challenge on OCSLA grounds only to the unitary net income base. (J.S. 12). The record in this case contains absolutely no evidence that would support any indication that the Iowa apportioned net income exceeds Shell's profits earned from its marketing activities in Iowa.

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REASONS FOR DISMISSAL OR AFFIRMATION

In *Shell Oil Company v. Department of Revenue, State of Florida*, appeal pending, No. 86-1593 (filed Mar. 20, 1987), Florida and the Solicitor General enumerated reasons why Shell's interpretation of the OCSLA is wrong. Iowa agrees with Florida and the Solicitor General that the OCSLA does not implicate a state apportioned net income tax scheme associated with the sale outside of the OCS of minerals extracted in the OCS. Iowa disagrees with the Solicitor General's recommendation that probable jurisdiction should be noted.

Principles underlying state unitary business/formula apportionment methods are well entrenched.[7] The states, in imposing upon multistate businesses their fair share of a tax upon their incomes associated with taxing state activities, can resort to formula apportionment to divide the unitary net income base between the taxing state and the rest of the world. The Constitution does not require a uniform method to be used by all states in this task. State rejection of separate accounting, as proposed by Shell to compute an OCS net income figure, is upheld, particularly where, as in this case, the taxpayer has made no effort to show that a facially reasonable apportionment method has resulted in taxation in excess of profits earned from activities within the taxing state. An allegation that a state tax operates to tax profits earned outside the state which is grounded upon a separate accounting method as proof is unfounded where, as in this case, Shell's separate accounting fails to consider contributions to income resulting from functional integration, centralized management, and economies of scale. Accordingly, if Shell's claim that Iowa taxed its OCS net income was founded upon Due Process or Commerce Clause analysis, Shell could not prevail. *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983); *Exxon Corp.*

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[7]When the OCSLA was adopted in 1953, this Court had firmly established the states' ability to require multistate businesses to divide their unitary net income bases by formula apportionment to reach results reasonably related to activities of the taxpayer in the taxing state. *Butler Brothers v. McColgan*, 315 U.S. 501 (1942); *Norfolk & Western Ry. v. North Carolina ex rel. Maxwell*, 297 U.S. 682 (1936); *Kent-Coffey Mfg. Co. v. Maxwell*, 291 U.S. 642 (1934), *aff'g per curiam* 204 N.C. 365, 168 S.E. 397 (1933); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

v. Wisconsin Department of Revenue, 447 U.S. 207 (1980)[8]; *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978); *Butler Brothers v. McColgan*, 315 U.S. 501 (1942); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113 (1920).

Shell seeks to sidestep the aforementioned apportionment precedents of this Court. In essence, Shell states that it need not prove that the amount of its net income apportioned to Iowa exceeds its Iowa profits. (J.S. 12). In Shell's view, all that it need show for relief under the OCSLA is an "income earned" figure that "is the increment of income that represents the net value at the wellhead . . . of the OCS production," (J.S. 2, n. 1), and that this calculation is used by Shell for other legitimate purposes. (J.S. 6). Upon the basis of Shell's separate accounting OCS net income computation, Shell maintains that its OCS net income is included in the overall unitary net income base and Iowa, by applying its apportionment formula to that base, has taxed at least some of that OCS net income so that the OCSLA is violated.[9]

The fundamental flaw in Shell's theory in this case is its assumption that Iowa, in fact, taxed its OCS income. There is no finding below that such taxation actually occurred and the record will not support one. In reviewing Shell's appeal, this Court would be guided by a record that would only support a finding that the Iowa unitary business/formula apportionment method "reached, and was meant to reach, only the profits earned within the State." *Underwood Typewriter*, 254 U.S. at 121. Shell's assertion that Iowa taxed its OCS "earned income" is as speculative as the taxpayer's assertion that its non-Iowa earnings were taxed in *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978).[10]

Even assuming, arguendo, that Shell's calculation of its OCS net income is correct (an assumption not grounded upon any finding of fact below in this case), Shell's argument that Iowa inevitably taxed a portion of that income is fundamentally flawed based upon the record in this case. "Obviously, all sales are not equally profitable." *Moorman*, 437 U.S. at 276. Shell's sales in Iowa may have yielded a much higher amount of Shell's profits than the apportioned profits. *Id.* If so, there would be no basis for any claim that Iowa taxed any OCS income. *Id.*

The unitary business/formula apportionment method utilizes a preapportioned unitary net income base that would include income from a variety of activities within and without the state. According to the Iowa Supreme Court, the apportionment formula selected by Iowa "aids in obtaining an accurate measure of the tax to be imposed

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[8]In *Exxon*, this Court rejected the very separate accounting method that Shell has used to compute an OCS "production income" as proof that the state extraterritorily taxed that "production income."

[9]Shell advocates its position here where the record does not show that the Iowa apportionment result exceeds profits that Shell earned as a result of its Iowa activities.

[10]Although *Moorman* is a Due Process and Commerce Clause precedent and this case revolves around the Supremacy Clause, the differences between these Constitutional provisions should not require different factual assumptions when claims are made that the taxing state is taxing income earned outside the state. The record either shows that Iowa taxed Shell's OCS net income or lacks such an evidentiary showing. It is absurd and illogical to conclude that, for Due Process and Commerce Clause purposes, the record fails to evidence an Iowa tax upon Shell's OCS net income, but such evidence somehow exists for OCSLA purposes.

as a result of Shell's Iowa activities." (J.S. App. 13a). There is no contrary evidence in the record to dispute the Court's statement. The makeup of the unitary net income base and state taxation of activities outside the taxing state are not inherently identical concepts, despite Shell's attempt to make them so. Even if Shell's assumption that its OCS "earned income" is included in the unitary net income base is valid, it falls short of proof that the Iowa apportioned result taxed a portion of that earned income in the absence of a showing that the Iowa apportioned result exceeded Shell's profits from its Iowa activities.

Accordingly, Shell's claim that Iowa taxed its OCS income earned from extraction of oil and gas is purely hypothetical. A substantial federal question grounded upon a constitutional claim of state taxation of income earned outside the taxing state is not raised when the claim is hypothetical. *United States v. Raines*, 362 U.S. 17 (1960). *See also Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978).

Since Shell cannot base its appeal in this case on any established fact that Iowa taxed its OCS net income, the only other basis for its claim for alleged violation of the OCSLA by Iowa is Shell's interpretation of the OCSLA that some sort of OCS income calculation must be made and deducted from the unitary income base and that OCS factors must be excluded from the apportionment formula. Within the context of this case, the issue is whether the OCSLA requires a modification of a state unitary business/formula apportionment method which has produced

a taxable net income that does not exceed the profits earned by the taxpayer in the taxing state.[11]

Taxation is a fundamental power, without which a state could not exist. Traditionally, this Court has been reluctant to disturb the distribution of powers between the states and the federal government. *United States v. Bass*, 404 U.S. 336, 349 (1971). "An intention to disturb the balance is not lightly to be imputed to Congress." *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 513 (1940). Thus, pre-emption of state law by federal law "is not favored in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion or that Congress has unmistakenly so ordained." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 634 (1981). Application of these principles to the instant case forecloses any interpretation of the OCSLA that would effectively restrict the fundamental power of states to tax income earned by activities within their borders.[12] Congress has not clearly expressed its intention for such restriction.

A significant indication that the OCSLA does not authorize Shell to reduce its Iowa apportioned net income attributable to its Iowa activities is the lack of any standards in the OCSLA for income attribution to the OCS.

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[11]The issue in this case becomes whether the OCSLA operates to shelter some of Shell's Iowa profits from Iowa taxation.

[12]This Court has recognized that a federal statute which provides for expansive exemption of federal obligations from state taxation should not be extended to create a "tax shelter" for subjects that are not federal obligations. *First National Bank of Atlanta v. Bartow County Board of Tax Assessors*, 470 U.S. 583, 597 (1985).

This Court could not develop any such uniform standards. *Moorman,* 437 U.S. at 278-9. There is no uniformity with respect to a separate accounting calculation of OCS income. *Thor Power Tool Company v. Commissioner of Internal Revenue,* 439 U.S. 522, 544 (1979). Moreover, nothing in the OCSLA would prevent each state, if Shell's position is adopted, from selecting its own and distinct separate accounting technique to compute an OCS net income figure, given the range of possible separate accounting techniques. In addition, different taxpayers could offer different separate accounting methods to compute an OCS "production income." This disharmony in the determination of OCS "production income" adds nothing to the policies underlying the OCSLA. Even if Shell's separate accounting technique is a useful tool for a variety of purposes, Shell has not been delegated the authority to prescribe a separate acounting method that other taxpayers and all states must follow.

Shell's separate accounting is merely its imperfect method of attempting to estimate an OCS net income figure for a segment of its unitary business. This imperfect method does not ensure the avoidance of any possible taxation by Iowa (or any other state) of any OCS net income since, by reason of the unitary nature of Shell's business, it is not possible to precisely source Shell's net income between OCS and non-OCS areas. Therefore, the "remedy" offered by Shell in this case of its internal accounting technique may be no remedy at all.[13]

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[13]Oil producers do not agree among themselves whether a "production income" that truly represents income associated with oil production can be accurately computed. In *Atlantic*

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The OCSLA clearly applies to those attempts by states to project their taxing authority into the OCS as if it were included within the borders of the taxing state. For example, any attempt by a state to impose a severance tax upon OCS production, a sales tax upon OCS wellhead sales, or a property tax upon OCS property would be clearly prohibited. In these instances, the activity or event in the OCS is taxed. Also, a state unapportioned income tax levied upon income-generating activities in the OCS would be proscribed. By contrast, a state apportioned tax associated with non-OCS activities in the taxing state, such as the Iowa unitary business/formula apportionment tax structure, does not inherently tax OCS activities, merely because OCS revenues and expenses are included within the apportionment.

A distinction between the Iowa *Shell* case and the Florida *Shell* case is that Florida excludes OCS wellhead sales to third parties from the unitary net income base and from the denominator of its apportionment formula sales factor while such sales are included by Iowa in the unitary net income base and in the sales formula denominator.

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Richfield Co. v. Alaska, 705 P.2d 418 (Alaska 1985), appeal dismissed, 106 S.Ct. 774 (1986) (Burger, C.J., and White and Stevens, JJ., dissenting), the Alaska Supreme Court had upheld a tax computed upon Alaska "production income." The oil producers who challenged the tax alleged that formula apportionment, not separate accounting, should have been used to reasonably establish their Alaska income. As previously pointed out, note 4, *supra,* Shell, itself, did not uniformly determine its Iowa apportioned income on its Iowa tax returns. Also, in the vast majority of states in which Shell files income tax returns, Shell does not exclude from its unitary net income base any computed OCS net income. (J.S. App. 61a; Stip. par. 25).

According to Florida, these exclusions are "founded solely upon provisions of the Florida Income Tax Code and not upon possible pre-emption attributable to a federal statute." (Fla. MDA. App. 14-14). Iowa has no such statutory provisions.

The inclusion of Shell's OCS wellhead third party sales in the unitary net income base and in the denominator of the Iowa formula and the Iowa taxation of any OCS profits are two distinct subjects; the former does not inevitably cause the latter. The Iowa Supreme Court recognized this distinction in noting that inclusion of OCS wellhead sales "aids in obtaining an accurate measure of the tax to be imposed as a result of Shell's Iowa activities." (J.S. App. 13a).

The Solicitor General, in No. 86-1593, states that the effect of the OCSLA "is thus to codify the constitutional proscriptions, set forth in the Due Process and Commerce Clauses, against state efforts to tax values that lie outside their jurisdiction." (U.S. Brief, 16). Iowa agrees. For Due Process and Commerce Clause purposes, the actual location or source of a sale consummated outside the taxing state is irrelevant.[14] Such sales location is not logically a determinant in measuring the value of the local tax base. The locus of Shell's natural gas sales does not inevitably dictate whether the Iowa tax is imposed upon a net income base that exceeds Shell's profits earned in Iowa. It is only this excess that could fall within OCSLA forbidden state extraterritorial taxation.

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[14]It is precisely because of the irrelevancy of the "source" of these sales that formula apportionment is resorted to by states to ascertain an estimate of the taxable value of profits incurred by activities in the taxing state.

Given the Solicitor General's statement that the OCSLA codifies constitutional guarantees against state extraterritorial taxation, it would be inconsistent for him to conclude that Iowa taxed Shell's OCS wellhead sales income merely because that income was included in the unitary net income base and in the denominator of the formula. (U.S. Brief 6, 16, 17). A determination whether the Iowa tax is imposed upon an income base in excess of Shell's Iowa profits cannot rest upon a factual foundation of whether sales of OCS minerals were consummated in the OCS or at some other non-Iowa location. Even Shell admits that the location of its sales is irrelevant for OCSLA analysis. (J.S. 23). The arbitrary standard of sales location to determine application of the OCSLA to state apportioned net income taxes would be exacerbated by the fact that contractual provisions between gas producers and pipeline companies differ. *Maryland v. Louisiana*, 451 U.S. 725, 730 (1981). These differences could cause otherwise similar gas sales to be consummated at different locations, some of which would be in and others off the OCS.

Shell asserts that the Solicitor General's position is that a state cannot include within its unitary net income base any profits from OCS wellhead sales to third parties. (J.S. 21). Iowa believes that this assertion is a distortion of the Solicitor General's position. The Solicitor General's position was that a state was prohibited by the OCSLA from taxing the earnings from OCS wellhead sales. (U.S. Brief, 6, 16, 17). This position is consistent with his conclusion that the OCSLA codified Due Process and Commerce Clause guarantees against state extraterri-

torial taxation.[15] (U.S. Brief 16). The Solicitor General believed that Iowa opined that it could tax OCS earnings. (U.S. Brief 17, n. 12). In fact, Iowa has not been of that opinion and the Iowa Supreme Court's decision did not approve of a tax imposed upon Shell's OCS earnings. Iowa takes the position that the OCSLA does not limit Iowa taxation of Shell's Iowa profits. That is how the Iowa Supreme Court perceived this case. (J.S. App. 13a). The Solicitor General's Brief disapproved of state taxation of OCS earnings, but the Brief did not condemn, and instead supported, the Iowa effort of inclusion of OCS revenues and expenses in the unitary business/formula apportionment in order to attain "an accurate measure of the tax to be imposed as a result of Shell's Iowa activities." (J.S. App. 13a).

The legislative history concerning the OCSLA clearly reveals that proponents and opponents of state taxation in the OCS wanted statutory language which would address the contours of state jurisdiction—or lack thereof—in the OCS area.[16] In short, Congress intended to codify a state

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[15]Florida's decision to exclude income from OCS wellhead sales from the unitary net income base and Florida apportionment formula does not detract from the notion that the location of sales outside the taxing state does not inevitably dictate whether the state is taxing earnings incurred outside of the state. Florida is free to elect these exclusions. States are not required to uniformly define the scope of the unitary income base or the factors in the apportionment formula. *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 167 (1983); *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978). Such uniformity is not required by the OCSLA.

[16]In *United States v. Louisiana*, 339 U.S. 699 (1950) and in *United States v. Texas*, 339 U.S. 707 (1950), this Court established the exclusive authority of the United States in the OCS to the exclusion of the States.

tax policy whereby state taxation was permitted or was prohibited. Ultimately, Congress chose the policy of state tax proscription in the OCS. These tax prohibition signals are in 43 U.S.C. § 1333(a). Shell argues that an interpretation of the OCSLA of codifying Due Process and Commerce Clause prohibitions against extraterritorial taxation renders the statute "superfluous" and "trivializes" the Congressional effort. (J.S. 23). Within the context of the Congressional debates, namely, the desire to address state taxation in the OCS, it cannot be said that an interpretation of the OCSLA to codify Due Process and Commerce Clause state tax proscriptions is "superfluous" or "trivial."

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CONCLUSION

Probable jurisdiction should not be noted. Shell's appeal should be dismissed or the decision of the Iowa Supreme Court should be affirmed.

Respectfully submitted,

THOMAS J. MILLER
Attorney General of Iowa
Hoover State Office Building
Des Moines, Iowa 50319
(515) 281-5164

Of Counsel

HARRY M. GRIGER
Special Assistant Attorney General
Hoover State Office Building
Des Moines, Iowa 50319
(515) 281-5846

Counsel of Record for Appellee

APPENDIX

EXHIBIT N

BEFORE THE IOWA STATE
DEPARTMENT OF REVENUE
HOOVER STATE OFFICE BUILDING
DES MOINES, IOWA

IN THE MATTER OF:	)	
	)	AFFIDAVIT
SHELL OIL COMPANY	)	OF JOHN
P. O. Box 2463	)	CHRISTENSEN
Houston, TX 77001	)	
	)	DOCKET NO.
CORPORATE INCOME	)	82-157-2A-A
TAX ASSESSMENT	)	

STATE OF IOWA)
) ss
COUNTY OF POLK)

JOHN CHRISTENSEN, of full age, being duly sworn according to law, upon his oath deposes and states:

1. My name is John Christensen. I received a B.A. degree in accounting in 1970 and an M.A. degree in business education in 1971 from the University of Northern Iowa. In September of 1973, I became a certified public accountant (CPA) and am so today. I commenced work with the Iowa Department of Revenue in September, 1972, wherein I audited Iowa corporate income tax returns in the Department's Corporate Audit Section. In October of 1976, I became supervisor of that section. In November of 1983, by reason of the Department's reorganization, I became a Technical Tax Specialist III in the Department's new policy section, with responsibilities associated with the Iowa corporate income tax and the Iowa franchise tax (imposed on financial institutions). I have had extensive audit experience, both office audit and field audit, of cor-

porate income tax and franchise tax returns. In this regard, I have to be familiar with various accounting methods used by various industries, including oil companies. Since Iowa corporate income tax and franchise tax net income is referenced to federal taxable income, with certain adjustments, I have also been required to have a general familiarity with the Internal Revenue Code. Over the years, I have been involved in a number of corporate income tax audits of oil companies doing business in Iowa. I am a member of the American Institute of Certified Public Accountants and of the Iowa Society of Certified Public Accountants.

2. I am familiar with the Stipulation in the instant contested case, Docket No. 82-157-2A-A, as it pertains to Shell's purported method of a separate accounting computation of its alleged net income from the outer continental Shelf (OCS), including the Schedule E exhibits.

3. In Shell's separate accounting method for OCS purposes, Shell appears to be using a functional approach, rather than a geographical approach. Under generally accepted accounting principles, a portion of Shell's refining and sales expenses associated with refining and sale of OCS minerals could be attributable to the OCS. Conceivably, these costs could be determined, if the data exists, on a per barrel basis. Shell's separate accounting method for the OCS does not attribute any refining and sales expenses to the OCS.

4. The refining and sales expenses associated with OCS minerals could, for example, be determined as follows, using a barrel formula:

$$\frac{\textit{barrel from OCS}}{\text{Total barrels}} \times \text{total refining costs} = \text{refining expenses attributable to OCS}$$

$$\frac{\text{Barrels of finished OCS products}}{\text{total barrels of finished products}} \times \text{total selling expenses} = \text{selling expenses attributable to OCS}$$

The results reached, however, by use of the above formulas are simply an approximation of expenses attributable to the OCS. When these expenses, along with the others in the Schedule Es, are used to determine an alleged OCS net income, if any, the resulting computation is merely an estimate of OCS net income and would not prove that the results reached by application of the Iowa sales formula to Shell's total net income, as was done in the audit of Shell's returns by the Department to determine an Iowa taxable income, taxed any income which Shell earned from the OCS.

5. Shell's Schedule Es for each year in question (1975-1980) do not purport to establish Shell's federal taxable income or Iowa taxable income as set forth in Iowa Code § 422.35.

6. Shell's Schedule E for each year in question (1975-1980), while purporting to be a computation of Shell's federal taxable income for Shell's OCS segment, is not a computation of segment federal taxable income pursuant to federal income tax laws and regulations, since those laws and regulations do not require a taxpayer to compute a federal taxable segment income, but require a computation of federal taxable income on a company-wide basis.

7. For the years 1975-1980, Shell's Iowa income tax returns denote that Shell computed its Iowa taxable in-

come by use of three different methods. First, for years 1975 and 1976, Shell attributed a portion of its total operating net income to Iowa by use of a three factor property-payroll-sales formula, without any deduction from the preapportionment net income base for a computed and separately accounted for OCS net income figure. Second, for years 1977, 1978, and 1979, Shell attributed a portion of its operating net income to Iowa, after deduction of a computed and separately accounted for OCS net income figure from the preapportionment net income base, by use of a sales factor formula. Third, for 1980, Shell attributed a portion of its total operating net income to Iowa by use of a sales factor formula, without any deduction from the preapportionment net income base for a computed and separately accounted for OCS net income figure.

8. Under generally accepted accounting principles, no income or loss can be recognized until a sale outside of the corporate structure occurs as distinguished from Shell's transfers from its E & P Organization to Shell's Products Organization which were transfers within the same corporate structure.

9. Generally accepted accounting principles or methods are designed to compute a company-wide net income. In addition, there are various accounting methods which can be used by a corporation in an attempt to compute a net income for internal management purposes. There are not, however, any generally accepted accounting principles or methods which are designed to determine the geographical source of net income. While Shell's separate accounting, as disclosed in its Schedule Es, can be used for purposes of computing depletion allowance as a deduction for federal and Iowa income tax purposes, this computation

of the depletion deduction is simply a method to determine that deduction, and not a method to determine federal taxable income or Iowa taxable income attributable to the OCS.

10. The figures computed by Shell on the Schedule Es, line 40 for 1975 and equivalent lines for the other Schedule Es, do not purport to be a precise measure of Shell's profits from the OCS and do not purport to identify the precise source of Shell's OCS profits, if any. Shell's computed OCS net income is merely an estimate by Shell. It is impossible, by use of accepted accounting methods, to compute a precise amount of net income, if any, from Shell's unitary business attributed to the OCS. Generally accepted accounting principles are designed along functional lines, and not strict geographical lines.

11. In my opinion, Shell's separate accounting methodology does not demonstrate that for the years in question (1975-1980), the effect of the June 10, 1982 assessment (Exhibit 10) is to impose Iowa income tax upon Shell's net income, if any, from the OCS.

/s/ John Christensen
John Christensen
Technical Tax Specialist III
Iowa Department of Revenue

Subscribed and sworn to before me this 10th day of December, 1984.

/s/ Connie Hoffman
Connie Hoffman
Notary Public